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CHARLES ELMORE CROPLEY

Supreme Court of the United States

OCTOBER TERM, 1942

No. 490

CLEARFIELD TRUST COMPANY, a corporation, and J. C. PENNEY COMPANY, a corporation,

Petitioners.

vs.

UNITED STATES OF AMERICA,

Respondent.

BRIEF OF PETITIONERS

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BRIEF OF PETITIONERS

I

The Opinions of the Courts Below

This action was instituted by the respondent in the United States District Court for the Western District of Pennsylvania. It was appealed to the Circuit Court of Appeals for the Third Circuit. This Court granted certiorari December 7, 1942. The opinion of the District Court is not reported but appears in the record (R. 20). The opinion of the Circuit Court of Appeals for the Third Circuit is reported in 130 Fed. (2d) 93 and is a part of the record (R. 26).

II

Jurisdiction

The jurisdiction of the United States District Court for the Western District of Pennsylvania was based upon the fact that the action was instituted by the United States as plaintiff, Title 28 U. S. C., Section 41(1). The jurisdiction of this Court is invoked by reason of its jurisdiction to review decisions of the Circuit Court of Appeals under Title 28, U. S. C. Section 347 (Judicial Code, Section 340, as amended).

III

Statement of the Case

This is an action brought by the respondent in the United States District Court for the Western District of Pennsylvania against the petitioners as guarantors of a prior forged endorsement upon a Treasury check collected by petitioners from the Treasurer through the Federal Reserve Bank of Philadelphia. The facts are stipulated (R. 13-17).

On April 28, 1936, a check for $24.20, dated at Harrisburg, Pennsylvania, was drawn on the Treasurer of the United States through the Federal Reserve Bank of Philadelphia by a disbursing clerk of the Treasury Department (R. 13). The check was payable to the order of Clair A. Barner for services rendered by him to the Works Progress Administration and was placed in the mail properly addressed to the payee at his address in Mackeyville, Pa. (R. 14). The check was obtained in some unknown manner by some unknown person other than the payee named therein (R. 14). A day or two after the check was mailed this person represented that he was Clair A. Barner and presented it to a store owned and operated by J. C. Penney

Company in Clearfield, Pennsylvania (R. 14). He identified himself as the payee to the satisfaction of the J. C. Penney Company employees, endorsed the check in the name of Clair A. Barner, and delivered it to J. C. Penney Company whose employees, believing in good faith that he was the owner of the check and entitled to the proceeds thereof, paid over to him cash or merchandise having a value of $24.20 (R. 14). The intended payee never received the check, never authorized the endorsement thereof, and did not participate in its proceeds (R. 14).

J. C. Penney Company promptly endorsed the check over to the Clearfield Trust Company which accepted it, as agent of J. C. Penney Company, for the purpose of collection. The Clearfield Trust Company endorsed the check "Pay to the order of the Federal Reserve Bank of Philadelphia Prior Endorsements Guaranteed.", collected it from the respondent through the Federal Reserve Bank of Philadelphia and paid the proceeds to J. C. Penney Company. Neither J. C. Penney Company nor the Clearfield Trust Company had any knowledge or suspicion that the endorsement was forged. The Clearfield Trust Company received the proceeds in good faith and paid them over to J. C. Penney Company which received such proceeds in good faith (R. 14, 15).

On or before May 10, 1936 the payee named in the check, Clair A. Barner, advised the timekeeper of the WPA project on which he was employed, and the foreman upon the same project, both of whom were respondent's agents, that he had not received the check. This information was duly communicated to other agents of the respondent and on November 20, 1936 the payee executed an affidavit alleging that his endorsement on the check was a forgery. The respondent did not notify the Clearfield Trust Company or J. C. Penney Company of the alleged forgery of said endorsement until January 12, 1937. On August 31, 1937 Clearfield Trust Company was first notified that the respondent was requesting reimbursement (R. 15).

The J. C. Penney Company store in Clearfield, Pennsylvania, cashes many hundreds of checks each year for purchasers or probable purchasers of merchandise. If a check is returned unpaid or is returned for reclamation a short time after the date on which it was cashed, the J. C. Penney Company employees can often locate the person who cashed the check through the one who vouched for him or by checking with the clerk who took the check and have him proceed immediately to locate the customer who cashed it (R. 16). At the time the Clearfield Trust Company and J. C. Penney Company were notified of the alleged forgery, however, which was approximately nine months after the check was cashed and more than eight months after the respondent received notice of the forgery, none of the J. C. Penney Company employees were able to remember anything about the transaction or the check in question, and although they made diligent inquiries they were unable to ascertain the identity of or to locate the person who presented the check or to effect a recovery from him. The Clearfield Trust Company acted only as the collection agent of J. C. Penney Company and had no knowledge with respect to the identity of the alleged forger (R. 16).

No effort was made by the respondent to explain its long delay after receiving notice of the forgery in passing such notice along to petitioners and respondent made no contention in the Court below or in the District Court that such delay was reasonable or excusable. The record shows plainly that although the respondent had it in its power to notify petitioners within ten (10) days after the check was cashed, its entirely unexplained and unreasonable delay of more than eight months deprived J. C. Penney Company of any chance which it might have had to protect itself by locating the alleged forger.

The respondent's position was and is that it has no duty to give prompt notice to endorsers of the alleged forgery of a prior endorsement or to assist them in any way in pro-

tecting their right to reimbursement. This is particularly evident from paragraph 12 of the stipulation (R. 16). Gwinn & Pell, attorneys for J. C. Penney Company, wrote the respondent as follows:

> "What disposition did the Secret Service make of the matter; that is, was any one prosecuted or not? If not was any one suspected of committing the crime? If so, what were the grounds of suspicion and why was it considered inadvisable to prosecute?"

It is evident that some of the information obtained as a result of the Secret Service investigation might well have been of assistance to J. C. Penney Company in conducting a further and more complete investigation and in obtaining restitution. Respondent's reply to this letter was as follows:

> "In this connection you are advised that the investigation did not disclose the identity of the negotiator. If the investigation had developed a suspect, it would not be advisable to furnish the name of the suspect and the grounds on which the suspicions were based until a trial had proved the suspicions were well founded" (R. 17).

It will be noted that respondent did not affirmatively state that there was no suspect but in effect stated that the only information which it would reveal in any case would be the result of a successful prosecution.

The United States District Attorney for the Western District of Pennsylvania instituted this action against the Clearfield Trust Company on November 16, 1939 (R. 1-4). J. C. Penney Company was added as a party defendant (R. 11-12). The case was tried before the District Court on the pleadings and the agreed statement of facts (R. 20). Relying upon *United States* v. *Guaranty Trust Company*, 293 U. S. 340, the District Judge held that the rights of the

parties were to be determined by the law of Pennsylvania. He concluded that under the applicable Pennsylvania law (*Market Street Title & Trust Co.* v. *Chelton Trust Co.*, 296 Pa. 230, 145 Atl. 848), respondent's failure to proceed with care and diligence in giving proper notice of the forgery of the payee's name operated as a bar to its right to recover and dismissed the complaint (R. 20).

The respondent appealed to the Circuit Court of Appeals for the Third Circuit. The principal issue before that Court was whether the case was governed by Pennsylvania law or by "federal law" as expressed by this Court in *United States* vs. *National Exchange Bank*, 214 U. S. 302. The *National Exchange Bank* case was decided prior to *Erie Railroad* v. *Tompkins*, 304 U. S. 64, and it was petitioner's contention that the *Tompkins* case and *United States* v. *Guaranty Trust Company*, 293 U. S. 341, required the application of the law of Pennsylvania. The Circuit Court of Appeals rejected this contention and held in substance that the case involved the construction of a federal statute, apparently because the W.P.A. was established pursuant to such a statute and because it is a crime under federal law to forge a check, 18 U. S. C. Sec. 262. The Circuit Court of Appeals relied upon *Board of Commissioners* vs. *United States*, 308 U. S. 343; *Deitrick* vs. *Greaney*, 309 U. S. 190; *Royal Indemnity Co.* vs. *United States*, 313 U. S. 289; and *D'Oench Duhme & Co. Inc.* vs. *Federal Deposit Insurance Corporation*, 315 U. S. 447.

IV

Specification of Errors

The Circuit Court of Appeals for the Third Circuit erred:

1. In reversing the judgment of the District Court.

2. In failing to apply the law of Pennsylvania in the instant case as a matter of right.

3. In applying general federal rules of law.

4. In ruling that it was obliged to follow *United States v. National Exchange Bank of Providence*, 214 U. S. 302 as the authoritative expression of the rule of federal law applicable.

5. In failing to elect to apply the Pennsylvania law as the federal rule in the instant case.

6. In failing to find that the federal law with respect to the duty of a drawer of a check to give notice to one to whom the check has been paid upon a forged endorsement is similar to the general rule on the subject as set forth on page 27 hereof.

7. In failing to presume in the absence of evidence to the contrary that petitioners were prejudiced by respondent's unreasonable delay.

8. In failing to hold that as a matter of fact and law petitioners were prejudiced by respondent's unreasonable delay.

9. In failing to affirm the judgment of the District Court.

V

ARGUMENT

Summary of Argument

Under the law of Pennsylvania the giving of prompt notice to endorsers by the drawer of a check after learning of the forgery of a prior endorsement is a condition precedent to an action against such endorsers to recover the amount paid to them on such check. Prejudice to such endorsers need not be affirmatively proved, but in the absence of evidence to the contrary is presumed. *Market Street Title & Trust Company* v. *Chelton*, 296 Pa. 230, 145 Atl. 848.

The respondent appears to concede that it is not entitled to recover in the instant case if the law of Pennsylvania is applicable. Respondent contends, however, that the case is governed by the federal law as expressed in *United States* v. *National Exchange Bank of Providence*, 214 U. S. 302, which appears to hold that the drawer of a check in a case such as the instant one has no duty to give notice of a prior forged endorsement and consequently that his right of action is not prejudiced by a failure to do so. *The National Exchange Bank of Providence* case was decided by this Court during that period in which the federal courts pursuant to the decision in *Swift* v. *Tyson*, 16 Pet. 1 applied their own concept of general common law rules in all cases and can no longer be found authoritative in view of *Erie Railroad Co.* v. *Tompkins*, 304 U. S. 64; *United States* v. *Guaranty Trust Company*, 293 U. S. 340 and *Royal Indemnity Co.* v. *United States*, 313 U. S. 289.

United States v. *Guaranty Trust Company*, 293 U. S. 341 holds that the respondent in issuing negotiable instruments acts in a non-sovereign capacity and upon the same plane as a private individual. As the operative facts in the instant case took place in Pennsylvania, the *Guaranty Trust*

Company case requires the application of the law of Pennsylvania. Furthermore, the Rules of Decision Act, 28 U. S. Code Sec. 725 requires the application of Pennsylvania law.

Board of Commissioners v. *United States*, 308 U. S. 343, *Royal Indemnity Co.* v. *United States*, 313 U. S. 289, *Deitrick* v. *Greaney*, 309 U. S. 190 and *D'Oench, Duhme & Co.* v. *Federal Deposit Insurance Corporation*, 315 U. S. 447 which were relied upon by the Circuit Court of Appeals are not applicable in the instant case for the reason among others that they do not involve negotiable instruments issued by the respondent in its non-sovereign capacity. Furthermore, the two cases in which state law was not applied were thought to involve frauds upon federal statutes and consequently the application of such statutes was more direct than is any alleged application of the federal statutes upon which the Circuit Court of Appeals relied in the instant case.

Even if this court is not bound to apply the law of Pennsylvania it should do so as a matter of discretion in view of the equities of the case. *Board of Commissioners* v. *United States*, 308 U. S. 343 and *Royal Indemnity Co.* v. *United States*, 313 U. S. 289. The Circuit Court of Appeals after purporting to follow these decisions further erred in assuming that it was obliged to apply the rule of the *National Exchange Bank of Providence* case as the applicable federal law.

If the federal rule is applicable and this court is not inclined to apply the law of Pennsylvania the expression of the federal rule as set forth in the *National Exchange Bank of Providence* case should be modified and brought into accord with the general rule that the drawer of a negotiable instrument which has been paid upon a forged endorsement loses his right of recovery if he fails to give notice promptly upon learning of the forgery and the person who received payment in good faith is prejudiced by such failure. The rule followed in Pennsylvania and Illinois should be adopted pursuant to which in the absence of evi-

dence to the contrary prejudice is presumed in the event of an unreasonable delay. If this rule is not to be adopted this Court should find that prejudice has been affirmatively proved where there is proof that a reasonable possibility of restitution which existed on the date on which the drawer received notice did not exist on the date on which he gave it.

POINT I

Under the law of Pennsylvania the giving of prompt notice to endorsers by the drawer of a check after learning of the forgery of a prior endorsement is a condition precedent to an action against such endorsers to recover the amount paid to them on such check.

The leading Pennsylvania case in support of the above proposition is *Market Street Title & Trust Co.* v. *Chelton*, 296 Pa. 230, 145 Atl. 848. In this case the plaintiff bank drew a check upon itself to the order of a third person. The check, as in the instant case, got into the hands of a person other than the one for whom it was intended and that person deposited it with the defendant bank for collection. The defendant endorsed the check "prior endorsements guaranteed," collected the money and turned it over to the wrongdoer. Fifty-two days after the payment of the check the true payee inquired about his money. This led to an investigation, the errors were discovered and about five days later the plaintiff notified the defendant of the alleged forgery and demanded a refund. The Supreme Court of Pennsylvania held that the defendant was not liable by reason of the plaintiff's delay which it found to be unreasonable saying at page 238:

> "In this State the rule of Price *v.* Neale was adopted and applied with great strictness, the paying bank not being allowed to recover back the amount of a forged check, credited in a customer's deposit book, even though the bank discovers the mistake

on the same day, and the depositor agrees to refund the money: Levy *v.* Bank of the United States, 1 Binney 27. To relieve against this severity, the rule was modified by Section 10 of the Act of April 5, 1849, P.L. 424, 426. It provides that where the signature of any 'drawer, acceptor, or endorser, shall have been forged, thereon', recovery back can be had by the payer: See Tradesman's Nat. Bank *v.* 3rd Nat. Bank, 66 Pa. 435; Corn Exchange Nat. Bank *v.* Nat. Bank of the Republic, 78 Pa. 233. This statute has not been repealed by the Negotiable Instruments Law, as amended by the Act of April 27, 1909, P.L. 260, Union Nat. Bank *v.* Franklin Nat. Bank, 249 Pa. 375. The Act of 1849, however, does not relieve the paying bank of all the duties required of it by the law merchant. . . .*

"Under the statute, therefore, although the time of discovery and notice ceased to be a matter of importance if the payee has in his hands, at the time demand is made upon him by the drawee, funds belonging to the wrongdoer (Union Nat Bank *v.* Franklin Nat. Bank, supra; U. S. Nat. Bank *v.* Union Nat. Bank, supra); yet the law presumes injury to the payee by delay and will not enter into a calculation as to whether injury did or did not occur; Leather Manufacturers Bank *v.* Morgan, 117 U. S. 96; McNeeley Co. *v.* Bank of N. Am. 221 Pa. 588, 594; Marks *v.* Anchor Savings Bank, 252 Pa. 304; Union Nat. Bank *v.* Farmers & Mechanics Bank, supra. This matter is well stated in the McNeeley Case (221 Pa. 594) as follows: 'This right is to proceed immediately, and to the promptness with which a bank is able to exercise it, recovery is often due. When a depositor withholds from his bank his knowledge of the forgery, he withholds from it this right to proceed promptly for its own protection. It may or may not be able to recover from the forger by promptly proceeding against him, but its right is to try by so proceeding; and when one of its depositors discovers that it has innocently sustained a loss, he

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* See Title 56, Sec. 29, Purdon's Pennsylvania Statutes Annotated.

ought, not only in all good conscience, but as a legal duty, to notify it at once of its mistake, for, by withholding from it what he has discovered, he can, as just stated, gain nothing, but it may lose all. A forger may be insolvent or beyond the reach of civil or criminal process, but by prompt proceedings against him, others may become interested in him and come to his assistance, who after delay may not do so. This incident to a bank's right to promptly proceed against a forger is not to be overlooked. Whenever a depositor knowingly withholds from it knowledge without which it cannot so proceed in an effort to protect itself, he ought to be regarded, when he comes to enforce alleged rights against it, as having withheld from it a substantial right, without regard to what might or might not have resulted from a prompt exercise of that right.'

"In this class of cases, the burden is always on the drawee to prove clearly that 'he gave notice as soon as he discovered the fraud' (State *v.* First Nat. Bank, 203 Pa. 69, 74) and that the pr[illegible]e then had funds from which he could recoup himself (Union Nat. Bank *v.* Farmers & Mechanics Bank, supra), otherwise the right to recover back is lost, and whether or not he performed his full duty is usually a question of law for the court: Marks *v.* Anchors. Savings Bank, 252 Pa. 304. In the instant case no excuse for the delay was even attempted . . ."

"In the light of the principles above stated, we have examined everyone of our cases since the decision of Iron City Nat. Bank *v.* Ft. Pitt Nat. Bank, supra, and find none which gives the slightest color to plaintiff's claim of a right to recover under the admitted facts here. In the case last cited it will be recalled that the drawee bank was refused the right to recover back, because of five days' delay in discovering the forgery; here we have 52 days delay in discovering the erroneous payment, and 5 days additional delay in notifying defendant, after plaintiff had actual knowledge thereof. In the case of a skillful forgery, there might be some excuse, in fact if not in law, in failing to detect it. Here, where the alteration in the name was patent, even that excuse fails.

> But there can be no excuse for a failure to give immediate notice after the facts are known. In State *v.* First Nat. Bank, 203 Pa. 69, 74, it is said: 'To recover from it, he was bound to give notice as soon as he discovered the fraud practiced upon him, and the burden was upon him, on the trial below, to show that he had given such notice. Not having done so he can not recover.' This is the rule in all of our cases" (p. 242).*.

The respondent conceded this to be the Pennsylvania law stating in a footnote in its brief before the Circuit Court of Appeals:

> "The law of Pennsylvania appears to be well settled that in order to recover against an indorser where the name of the payee has been forged, notice of the forgery must be given to such indorser promptly after discovery of the forgery. Delay alone has been held to operate as a bar, and no special damage resulting from such delay need be shown. Market Street T. & T. Co. *v.* Chelton T. Co., 296 Pa. 230, 145 Atl. 848; Commonwealth Trust Co. *v.* First National Bank, 265 Pa. 60, 108 Atl. 144; McNeeley Co. *v.* Bank of North America, 221 Pa. 588, 70 Atl. 891."

The respondent apparently did not deny that it was barred from recovery if the Pennsylvania Rule is applicable. The Circuit Court of Appeals clearly took such a position saying:

> "If the rights of the plaintiff are to be determined by Pennsylvania decisions the judgment of the lower court was right. It seems to us clear that under the

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*The Chelton opinion may seem somewhat severe in ruling that a five day delay in notification is unreasonable. The Pennsylvania Courts recognize, however, that in a case in which the drawer is a large corporation or governmental body a reasonable time may be longer than in the case of an individual. *Commonwealth* v. *Globe Indemnity Co.*, 323 Pa. 261, 185 Atl. 769. No contention has or can be made in the instant case that the delay of more than eight months was reasonable.

> Pennsylvania rule the rights of a drawer to recover against one who has received payment of a check under a forged endorsement are conditioned upon his giving prompt notice of the forgery. Market St. Title & Trust Co. *v.* Chelton Trust Co., 1929, 296 Pa. 230, 145 A. 848. We do not think the force of this rule can be avoided by describing it as a rule of laches and, therefore, not operative against the United States. If it applies at all it precludes recovery for it is hardly arguable here that notice to the defendant was given with reasonable promptness." 130 Fed. (2d) 93, 94 (R. 27).

As previously stated, however, respondent's contention, which was sustained by the Circuit Court of Appeals, is that the case is governed by the "federal rule" as expressed in *United States* v. *National Exchange Bank of Providence*, 214 U. S. 302.

POINT II

The instant case is governed by the law of Pennsylvania.

The check in the instant case was drawn at Harrisburg, Pennsylvania (R. 5) for W.P.A. services rendered in Pennsylvania. It was mailed, addressed to the payee at Mackeyville, Pennsylvania. It was endorsed and delivered to J. C. Penney Company in Clearfield, Pennsylvania, deposited for collection with the Clearfield Trust Company and collected by the Clearfield Trust Company from the account of the Treasurer in the Federal Reserve Bank of Philadelphia (R. 14-15). The District Judge after reciting these facts said: "We conclude, therefore, that the rights of the parties are to be determined by the law of Pennsylvania: *United States* v. *Guaranty Trust Company*, 293 U. S. 340, 346." (R. 21).

The Circuit Court of Appeals disapproved of this view saying:

> "We think the question is rather whether the rule of Erie R. Co. *v.* Tompkins, 1938, 304 U. S. 64, 58 S. Ct.

817, 82 L. Ed. 1188, 114 A. L. R. 1487, applies so that we are constrained to look to the law as declared by the state courts as a measure of the rights and liabilities of the parties. We think it does not so apply. The plaintiff is not in federal court by virtue of diversity of citizenship, but by the expressed provision of the Judicial Code giving it the right to sue. The payment for which this check was given grew out of services performed under an Act of Congress, the Federal Emergency Relief Act. 15 U. S. C. A. ch. 16, §§ 721-728. The forgery was an offense against the laws of the United States (18 U. S. C. A. 262). We think all these facts distinguish the situation from that presented in Erie R. Co. *v.* Tompkins, supra, where under the diversity of citizenship clause the sole purpose of federal court jurisdiction is to provide a tribunal to dispense justice impartially between citizens of different states. Our conclusion is strongly supported by a group of decisions in which the Supreme Court has been called upon to determine, in the light of Erie R. Co. *v.* Tompkins and cases following it, whether a particular question not expressly answered by the Constitution, treaties or statutes of the United States is to be determined by reference to state precedents or by federal courts in the light of their own body of decisions and their own notions of the proper rule of law. Thus the matter of interest in the recovery of taxes improperly assessed upon Indian lands was held to be a matter concerning which state decisions were not controlling. (Board of Commissioners *v.* United States, 308 U. S. 343) The same result was reached where the problem was 'the judicial determination of the legal consequences which flow from acts condemned as unlawful by the National Bank Act * * *' (Deitrick *v.* Greaney, 309 U. S. 190) So, too, the liability for interest of a surety on a bond furnished the United States to accompany a taxpayer's claim for abatement of tax liability was held to be a question upon which state decisions did not control the answer given by the federal court. (Royal Indemnity Co. *v.* United States, 313 U. S. 289) Likewise, the majority of the Court held it a federal question whether one who had given a note to a bank as part of a plan to

conceal its overdue bonds was liable even though the note was given prior to the formation of the Federal Deposit Insurance Corporation. (D'Oench, Duhme & Co. *v.* F. D. I. C., 315 U. S. 447) In the absence of an authoritative decision by the Supreme Court of the United States to the effect that Erie R. Co. *v.* Tompkins applies only in cases of diversity of citizenship a subordinate federal tribunal would be exhibiting uncalled for temerity in offering such generalizations. We do not do so here. But we do think, however, that in this case the facts in litigation originate fully as directly from the Constitution and statutes of the United States as in the Supreme Court cases just mentioned and in this case, as well as in those, the federal courts are not bound in their determination of the legal consequences of the transaction by what the courts of the state, where the operative facts occurred, have held with regard to the general question involved" (130 Fed. 2d 93, 94).

The decision of this court in *United States* v. *Guaranty Trust Company*, 293 U. S. 340 upon which the District Court relied is squarely in point. In that case a Treasury disbursing clerk mailed a Veterans Bureau check to the payee in Yugoslavia. The letter was never received by the payee. Some other person received it, endorsed the name of the payee and deposited it in a bank in Yugoslavia. Thereafter the check was again endorsed and delivered to the Guaranty Trust Company for collection. The Guaranty Trust Company endorsed the check "prior endorsements guaranteed" and collected it through the Federal Reserve Bank of New York. Later the Treasury learning of the forgery demanded reimbursement from the Guaranty Trust Company. The Guaranty Trust Company proved that under the law of Yugoslavia good title might be passed notwithstanding a forged endorsement. This Court said that since the check was forwarded by the Treasury to Yugoslavia it must under normal rules of conflicts be deemed to have intended that the check might be negotiated according to the law of that country. This Court concluded,

therefore, that the Guaranty Trust Company received good title to the check.

The Circuit Court of Appeals sought to distinguish this case saying:

> "That case, however, only declared a conflict of laws rule as to the title acquired in a foreign country by a transferee under a forged endorsement. It does not settle this case." 130 Fed. (2d) 93, 94 (R. 27).

We are unable to comprehend this purported distinction. It is, of course, true that the *Guaranty Trust Company* case does declare a rule of conflict of laws. It held that when the respondent acting in its non-sovereign capacity issues a negotiable instrument and forwards it to a particular jurisdiction, the law of that jurisdiction is applicable to its transfer. In the instant case, however, the respondent, likewise acting in a non-sovereign capacity issued and delivered its check in Pennsylvania and paid it there. Under a rule of conflict of laws fully as well settled as that applied in the *Guaranty Trust Company* case the law of Pennsylvania is applicable here. The point of similarity of the *Guaranty Trust Company* case which is controlling is that pursuant to a conflict of laws rule the law of the situs of the transaction rather than a general federal rule was applied.

We see no more reason why a federal rule of law should be applied in the instant case than in the *Guaranty Trust Company* case. Certainly there was exactly the same basis in that case as in the instant one for holding that a construction of 18 U. S. Code Sec. 262 imposing a criminal penalty for the forging of United States checks was involved (130 Fed. (2d) 93, 94). Similarly, if the Circuit Court of Appeals was correct in the instant case in holding that a construction of the Federal Emergency Relief Act is at issue, this Court should have held in the *Guaranty Trust Company* case that a construction of the pension statutes was before the Court.

It is quite apparent from his opinion in the *Guaranty Trust Company* case that Mr. Justice Brandeis did not have

in mind any such distinction as that relied upon by the learned Circuit Court of Appeals for he said at page 346:

> " . . . The argument is that, since the check was both drawn and payable within the District, the obligation arising therefrom is governed by its laws; that, under the law of the District the drawer agreed to pay the check only on the order of the payee; and that since there was no such order and the payment made was in ignorance of the forgery, the money may be recovered as having been paid under a mistake. The law of the District determines the formal and essential validity of the check, the interpretation of the contract, the incidents of the obligation. . . . "*

He continued at Page 348:

> "Third. The Government contends that irrespective of considerations discussed above, the Trust Company is liable because of its endorsement. The argument is that its endorsement, made when the check was presented for payment through the Federal Reserve Bank of New York, is an independent contract governed by the law of New York, Spies *v.* National City Bank, 174 N. Y. 222, 225; 66 N. E. 736; that, by the Negotiable Instruments Law of that State, the endorsement warrants, besides the title, the authenticity of penmanship of the payee or the authorization of the endorsement in his name, and that, if there be doubt as to the meaning and effect of an endorsement under the law of New York, there can be no doubt as to the Trust Company's obligation, because of the terms of its stamp; "Prior endorsements guaranteed."

Mr. Justice Brandeis said the law of the place of delivery and payment not a general federal rule determines the validity of the check and the interpretation of the con-

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* The check in the *Guaranty Trust Company* case was drawn directly on the Treasurer. It was not made payable through one of the Federal Reserve Banks as was the check in the instant case.

tract.* He indicates that the government contended that the construction of the guaranty of endorsements involved the law of the place where the guaranty was made, not the federal law. It is perfectly obvious that respondent's position in the instant case is an abrupt departure from that previously taken by it both before this and other Courts. (See *United States* v. *Citizens Union National Bank*, 40 Fed. Supp. 609 [D. C. W. D. Ky.]) and from the law as applied in cases similar to the instant one since the decision of this Court in the *Tompkins* case. *Security First National Bank of Los Angeles* v. *United States*, 103 Fed. (2d) 188 (C. C. A. 9), *United States* v. *National City Bank of New York*, 28 Fed. Supp. 144 (D. C. S. D. N. Y.).

The Circuit Court of Appeals in sustaining respondent's revised position relied upon *Board of Commissioners* v. *United States*, 308 U. S. 343; *Deitrick* v. *Greaney*, 309 U. S. 190; *Royal Indemnity Company* v. *United States*, 313 U. S. 289; *D'Oench Duhme & Co.* v. *Federal Deposit Insurance Corporation*, 315 U. S. 447.

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* This position seems in accord with the principle that the United States acts in a non-sovereign capacity in issuing negotiable instruments:

> " . . . As against the United States, the rights of the holder of its checks drawn upon the Treasurer are the same as those accorded by commercial practice to the checks of private individuals. Compare United States *v.* National Exchange Bank, 270 U. S. 527, 534; Lynch *v.* United States, 292 U. S. 571, 579. Moreover, the Government expressly disclaimed the assertion of a preferred position." *United States* v. *Guaranty Trust Company*, 293 U. S. 340, 350. See also *United States* v. *National Exchange Bank*, 270 U. S. 527.

If the rights of the respondent are those of a private individual it must follow that the legal consequences of its acts in Pennsylvania with respect to negotiable instruments are governed by Pennsylvania law.

Board of Commissioners v. *United States*, 308 U. S. 343, was a suit by the United States on behalf of an Indian to recover real estate taxes exacted by the state in violation of a federal treaty. Neither the treaty nor any federal statute covered the question as to whether or not interest might be recovered. The majority of this Court concluded that the interest was in substance the damage for violation of the treaty and as such involved a federal question. The Court applied the law of Kansas as a matter of discretion, however.

Royal Indemnity Company v. *United States*, 313 U. S. 289 is very similar to the Board of Commissioners case. The question involved was what law governs the rate of interest in a suit by the United States upon a surety bond given in connection with an assessment of federal income tax. This Court held that this also presented a federal question even though it was not expressly covered by statute. As a matter of discretion, however, it applied the rate as established by the law of New York in which state the bond was given.

In *Deitrick* v. *Greaney*, 309 U. S. 190 the defendant gave his note to a bank to purchase shares of the bank's stock. It was orally agreed, however, that the note was not to be paid and that the bank was to retain its interest in the stock. The receiver of the bank sued upon the note and the defendant sought to rely upon the oral agreement as a defense. The District Court found that the entire transaction was devised and carried out in order to conceal the bank's ownership of its own capital stock in violation of 12 U. S. Code Sec. 83. Although the point at issue was not expressly covered in the federal statute this Court held that a question of its construction was involved and that the defendant was estopped from relying upon the oral agreement.

In *D'Oench, Duhme & Co.* v. *Federal Deposit Insurance Corporation*, 315 U. S. 447 the defendant which was engaged in the securities business and which had sold a bank some

bonds which were not paid when due, delivered notes to the bank in order that it might avoid showing the bonds as defaulted. The bank gave a written memorandum stating that the notes would not be called for payment. The Federal Deposit Insurance Corporation insured the bank and acquired the notes as a part of its collateral. Upon suit on the notes by the Federal Deposit Insurance Corporation this Court held that a federal question of protecting that federal corporation arose and that the general policy of the law would not permit the defendant to defend upon the basis of its secret agreement.

It is apparent from the foregoing that none of the cases relied upon by the Circuit Court of Appeals are very closely in point. None of them involve negotiable instruments issued by the respondent in its non-sovereign capacity and they are therefore quite distinguishable upon this basis alone. Furthermore, *Deitrick* v. *Greaney* and *D'Oench, Duhme & Co.* v. *Federal Deposit Insurance Corporation* are distinguishable upon the ground that in those cases actions of the defendants were considered to be attempted frauds upon the federal law which the majority of this Court felt it necessary to strike down in order to give full effect to the intent of Congress. No such consideration is involved in the instant case.

Board of Commissioners v. *Young* and *Royal Indemnity Company* v. *United States* hold that damages for the breach of a federal treaty and for the breach of a bond given to the Treasury in connection with a contest of a tax assessment raise questions of federal law, notwithstanding the lack of any express provisions in the federal statutes. These cases seem to us to go about as far as is permissible in the face of the Rules of Decision Act, 28 U. S. Code Sec. 725. The *Royal Indemnity Company* case is perhaps the most nearly in point, but it involves a bond taken by the respondent to protect itself in the exercise of its sovereign function of collecting taxes. None of the cases purport to overrule the *Guaranty Trust Company* case and declare federal law ap-

plicable to negotiable instruments issued by the federal government in its non-sovereign capacity.*

However sound the reasons may be for finding that the damages for breach of a federal treaty and a bond required to protect the Treasury under the tax laws involve questions of construction, we submit that there can be no justification under the circumstances of the instant case for disregarding the Rules of Decisions Act which provides:

> "Laws of States as rules of decision. The laws of the several States, except where the Constitution, treaties, or statutes of the United States otherwise require or provide, shall be regarded as rules of decision in trials at common law, in the courts of the United States, in cases where they apply." 28 U. S. Code Sec. 725.

There is no federal negotiable instruments law and if the various state acts are not applicable the whole field will certainly be thrown into the greatest confusion Presumably, an attempt to find federal rules upon most negotiable instruments questions would render it necessary to inquire into the common law cases of colonial times. Doubtless if Congress had wished to do so it might have enacted a federal negotiable instruments law covering all aspects of negotiable instruments issued by the United States, and it still may do so if it finds that such an act is necessary in the interest of uniformity. In the absence of such

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* Mr. Justice Jackson's concurring opinion in *D'Oench, Duhme & Co. v. Federal Deposit Insurance Corporation* which seems strongest in urging the applicability of federal law to the facts of that case is significant on this point:

> ". . . No doubt many questions as to the liability of parties to commercial paper which comes into the hands of the Corporation will best be solved by applying the local law with reference to which the makers and the insured bank presumably contracted . . ." (P. 474) See also 16 Temple University Law Quarterly 336.

legislation, however, we submit that the field of negotiable instruments presents a peculiarly apt place for the application of state law and that the federal courts should not at this late date undertake the construction of a general federal code upon the basis of common law precedents under the pretext of construing federal laws having little or no connection with negotiable instruments.

It should be noted that in the *Board of Commissioners* and *Royal Indemnity* cases state rules of law were applied by this Court as a matter of discretion. We submit that even if the Circuit Court of Appeals was correct in holding that the instant case is to be governed by federal law, it should have fully followed the *Board of Commissioners* and *Royal Indemnity Co.* decisions in adopting the law of Pennsylvania in the instant case instead of feeling obliged to follow *United States* v. *National Exchange Bank*, 214 U. S. 302 decided during the era of *Swift* v. *Tyson*, 16 Pet. 1.

The respondent as above set forth has upon numerous occasions taken the position that its checks are governed by state law. Upon this understanding it has circulated such instruments and received the free use of the commercial and banking structure of the country as a means of having them presented for collection. As we understand the practice of the Treasury and the Federal Reserve Banks a private individual who receives a Treasury check has no right to present it directly to the Treasurer or to a Federal Reserve Bank for payment. He must present it for collection by another bank. The banks and merchants who accept these checks rely and are entitled to rely upon their form as negotiable instruments and to assume that in issuing them in such form the Treasury intends them to circulate in the same manner as other negotiable instruments which may be isued by individuals in the same locality. If a greater degree of protection for the Treasury is necessary in connection with these matters such protection can easily be accomplished through the issuance of non-negotiable warrants or by making payments in cash. As has been

heretofore stated, however, the law is well settled that in issuing negotiable instruments, the United States acts in its non-sovereign capacity and on the same plane as a private individual. See footnote, page 19. In view of this rule we see no reason why the Treasurer in issuing and paying negotiable instruments in Pennsylvania and in using Pennsylvania facilities for their collection should not abide by Pennsylvania law.

There is no reason why the officers of the respondent who receive notice of a forgery may not be—just as any officer of a private corporation must be—instructed to report an alleged forgery immediately to a proper official for the purpose of giving notice. In *United States* v. *National Exchange Bank*, 270 U. S. 527 it was urged that because of its magnitude it was unreasonable to require the paying agents of the respondent to recognize the signatures of all disbursing agents. Mr. Justice Holmes rejected this argument saying at page 534:

> "We are of opinion that the United States is not excepted from the general rule by the largeness of its dealings and its having to employ agents to do what if done by a principal in person would leave no room for doubt."

Every reasonable consideration requires the United States to give notice promptly in a case of this sort and there is no reason on earth why the efforts of endorsers to secure restitution should be held up or prompt action of state authorities prevented. For the foregoing reasons we respectfully submit that the law of Pennsylvania should be applied in the instant case.

POINT III

United States v. _National Exchange Bank of Providence_, 214 U. S. 302 should be modified and brought into accord with the general rule that the drawer of a negotiable instrument which has been paid upon a forged endorsement loses his right of recovery if he fails to give notice promptly upon learning of the forgery and the person who received payment of such instrument in good faith is prejudiced. In the absence of evidence to the contrary prejudice is presumed from an unreasonable delay in giving notice. Furthermore, sufficient prejudice is affirmatively proved by evidence that a defendant's chances of restitution were impaired by the delay.

The Circuit Court of Appeals in its opinion below relied upon *United States* v. *National Exchange Bank of Providence*, 214 U. S. 302 as expressing the Federal rule applicable, It said:

> "Since it is concluded that the Pennsylvania decisions are not controlling, the matter is to be decided as a federal question from the 'materials in hand'. In this instance we already have an authoritative decision in United States *v.* National Exchange Bank of Providence, 1909, 214 U. S. 302, 29 S. Ct. 665, 53 L. Ed. 1006, 16 Ann. Cas. 1184. Here it was held that the United States could recover from a bank which received the money on pension checks where the names of the payees had been forged and that the right to recover was not conditioned either on demand or the giving of notice. This decision makes the federal rule in cases where it is applicable for all lower federal courts. It governs us here." (130 Fed. (2d) 93, 95)

In the *National Exchange Bank* case certain pension vouchers purporting to be executed by the correct persons but actually executed by others were forwarded to the

United States pension agent who drew checks to the order of the proper pensioners and forwarded them to the addresses given in the vouchers. The checks were cashed on forged endorsements by the National Exchange Bank which in turn collected them through its Boston correspondent. In May 1897, a special examiner of the Pension Bureau was detailed to investigate one of the cases and on June 18, 1897 he reported that the endorsements were probably forged. Notice of this was given to the defendant on December 18, 1897. Other forgeries were discovered during the year 1898. On July 12, 1898 the United States District Attorney made a demand for repayment as to some of the checks; as to others no demand was made until suit was commenced in August 1909. One defense raised by the defendant bank was the failure of the plaintiff to give prompt notice upon discovery of the alleged forgeries. As to this the Court concluded:

> "Under these conditions the warranty of genuineness implied by the presentation and collection of the checks bearing the forged indorsement having been broken at the time the checks were cashed by the United States, and the cause of action having therefore then accrued, the right to sue to recover back from the Exchange Bank was not conditioned upon either demand or the giving of notice of the discovery of facts which by the operation of the legal warranty were presumably within the knowledge of the defendant" (p. 320).

The rule seems to be broadly stated that the United States owes no duty to give notice to endorsers as a condition precedent to its right to collect and that, therefore, a failure to give such notice does not affect its cause of action.

This conclusion is not in accord with the general weight of authority. The general rule is stated in 25 A. L. R. 177 as follows:

> "Unreasonable delay, after his discovery of the forgery, on the part of one having the opportunity

> and duty to speak, in disclosing a forgery upon commercial paper to the one who ought to be apprized thereof, estops the former from thereafter asserting the forgery as against the latter, where the latter is prejudiced by such delay or failure.'"*

See also 50 A.L.R. 1374; 116 A.L.R. 1470.

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* The exact nature of this defense has been the subject of some confusion. In the Court below the respondent contended that the rule is one of laches and not operative against the United States. The Circuit Court of Appeals correctly concluded that the rule is applicable to the respondent, 130 Fed. (2d) 93, 94. *Ladd & Tilton Bank* v. *United States*, 30 Fed. (2d) 334; *United States* v. *National Rockland Bank*, 35 Fed. Supp. 912 (D. C. Mass.); *United States* v. *National City Bank of New York*, 28 Fed. Supp. 144 (D. C. S. D. N. Y.).

The right to recover money paid under a forged endorsement is generally regarded as arising from the common law principle permitting the recovery of money paid under a mistake of fact. As this principle is equitable in nature recovery is denied when the plaintiff has been guilty of an inequity in failing to give notice promptly. See *United States* v. *Union National Bank*, 28 Federal Cases 16, 597 (D. C. S. D. N. Y. 1879). See also *United States* v. *National Exchange Bank of Providence*, 214 U. S. 302, 320. The same result may be reached by construction of Sec. 23 of the Uniform Negotiable Instruments Law which provides:

> "When a signature is forged or made without the authority of the person whose signature it purports to be, it is wholly inoperative, . . . unless the party, against whom it is sought to enforce such right, is precluded from setting up the forgery or want of authority." (Title 56 Sec. 28, Purdon's Pennsylvania Statutes Annotated.)

There are few decisions construing the meaning of the word "precluded".

In Pennsylvania the rule seems to have been reached in a rather peculiar manner. In an early case the rule of

(Footnote continued on next page)

As a matter of fact the lower Federal Courts appear to have undertaken to follow the rule as above set forth despite the fact that *United States* v. *National Exchange Bank of Providence* seems inconsistent therewith. *Ladd & Tilton Bank* v. *United States*, 30 Fed. (2d) 334; *United States* v. *National Rockland Bank*, 35 Fed. Supp. 912 (D. C. Mass.); *United States* v. *National City Bank of New York*, 28 Fed. Supp. 144 (D. C. S. D. N. Y.). Furthermore, there is considerable question as to whether *White* v. *Continental National Bank*, 64 N. Y. 316 (1876) upon which this court relied in *National Exchange Bank of Providence* case still represents the law of New York. See *Dorsey* v. *President & Directors of Manhattan Co.*, 33 N. Y. Supp. (2d) 69, (Mun. Ct. City of N. Y. 1941).

Substantially all authorities except the decision of this court in the *National Exchange Bank of Providence* case indicate that an unreasonable delay, on the part of the drawer of a check in giving notice after discovering a forgery causes him to lose his cause of action if the person from whom he seeks to recover was prejudiced by his delay.

Price v. *Neale*, which is properly applicable only to the signature of a drawer, seems to have been applied to prevent recovery in a case involving a forged endorsement. See the quotation from *Market Street Title & Trust Company* v. *Chelton* on Page 10 hereof. A statute was enacted to limit the application of this case (Title 56, Sec. 29 Purdon's Pennsylvania Statutes Annotated) and the *Market Street* case appears to be a construction both of the statute and of the contractual guarantee of prior endorsements in the light of common law precedents.

It should be noted that the express guarantee of prior endorsements in the *Market Street Title & Trust Company* case did not affect the application of the rule referred to above and it is well settled that such a guarantee is no broader than that which the law implies from a general endorsement. *United States* v. *Guaranty Trust Company*, 293 U. S. 340; *Security First Bank of Los Angeles* v. *United States*, 103 Fed. (2d) 188; *United States* v. *National City Bank of New York*, 28 Fed. Supp. 144 at p. 150.

The difficult question which arises in the instant case relates to the degree of prejudice which must be shown.

The record contains the following paragraphs in the stipulation of facts:

> "9. The J. C. Penney Company store in Clearfield, Pennsylvania, cashes many hundreds of checks each year for purchasers or probable purchasers of merchandise. If a check is returned unpaid or is returned for reclamation a short time after the date on which it was cashed, the J. C. Penney Company employees can often locate the person who cashed the check through the one who vouched for him or by checking with the clerk who took the check, and having him proceed immediately to locate the customer who cashed it."
>
> "10. At the time the Clearfield Trust Company and J. C. Penney Company were notified of the alleged forgery, none of the J. C. Penney Company employees were able to remember anything about the transaction or the check in question, and although they made diligent inquiries, they have been, and still are, unable to ascertain the identity of, or to locate, the person who presented said check to it or to recover the money and/or merchandise paid over to him. The Clearfield Trust Company acted in the transaction only as the collection agent of J. C. Penney Company and has no knowledge with respect to the identity of the alleged forger" (R. 16a).

The Circuit Court of Appeals held this showing of prejudice to be insufficient saying:

> ". . . Since that decision (*United States* v. *National Exchange Bank of Providence*, 214 U. S. 302) it has been several times held that where notice of the forgery has been unreasonably delayed the endorsee under the forged endorsement is nevertheless protected if he shows loss resulting to him from the unreasonable delay. The facts in this case, however, fall short of such proof.

> "The most they show is that if notice is given promptly J. C. Penney employees can often locate the person who cashed a check at their store and that in this case inquiries have failed to locate the person who presented the check out of which this litigation arises. The most that can be concluded from this is that if they had had a prompter notice they might have been able to locate the imposter. This is insufficient to take the case out of the rule of the United States *v.* National Exchange Bank of Providence, supra" (130 Fed. 2d 93, 95).

The few cases upon this subject of prejudice are in considerable confusion and few text writers appear to have attempted to struggle with it. It must be conceded that some cases go to the extent of declaring that the defendant must present what amounts to absolute proof that he could have collected had prompt notice been given and that a possibility or probability is not enough. *Third National Bank* v. *Merchants National Bank*, 27 N. Y. Supp. 1070 (Sup. Ct. 1894).

On the other hand, the rule followed by the Courts of Pennsylvania, Illinois and various other states is that generally a person's chances of reimbursement from the forger are diminished by an unreasonable delay and in the absence of evidence to the contrary prejudice to him will be presumed. *National Bank of the Republic of Chicago* v. *Kaspar American State Bank*, 369 Ill. 34, 15 N. E. (2d) 721. See also *United States* v. *Clinton National Bank*, 28 Fed. 357 (C. C. S. D. Iowa 1886). The Supreme Court of Pennsylvania in the *Chelton* case explained its basis for the rule as follows:

> ". . . When a depositor withholds from his bank his knowledge of the forgery, he withholds from it this right to proceed promptly for its own protection. It may or may not be able to recover from the forger by promptly proceeding against him, but its right is to try by so proceeding; and when one of its depositors discovers that it has innocently sustained

> a loss, he ought, not only in all good conscience, but as a legal duty, to notify it at once of its mistake, for, by withholding from it what he has discovered, he can, as just stated, gain nothing, but it may lose all. A forger may be insolvent or beyond the reach of civil or criminal process, but by prompt proceedings against him, others may become interested in him and come to his assistance, who after delay may not do so. This incident to a bank's right to promptly proceed against a forger is not to be overlooked. Whenever a depositor knowingly withholds from it knowledge without which it can not so proceed in an effort to protect itself, he ought to be regarded, when he comes to endorse alleged rights against it, as having withheld from it a substantial right, without regard to what might or might not have resulted from a prompt exercise of that right."

We submit that this is the reasonable and correct rule.

In the instant case respondent was notified of the forgery only a few days after the check was cashed in the J. C. Penney Company store. If prompt notice had been given it is certain that the employees involved could have remembered the transaction. Whether or not they could have located the forger is open to question. The record shows that this can often be done, however. This conclusion may be emphasized by calling the Court's attention to the fact that all forgeries are not perpetrated by accomplished criminals. We believe that many forgeries, particularly those involving small checks occur because a friend, neighbor or relative obtains possession of a check belonging to another. The forger in such a case would ordinarily reside in the community to which the check was directed and would not be expected to flee the country because he had unlawfully obtained $10.00 or $20.00.

There is also the question as to whether or not restitution could have been obtained even if the forger had been located. No positive statement either way can be made on this point. Often forgers do make restitution, however, in

the hope of avoiding prosecution or securing lighter sentences. The small amount involved is pertinent since few persons would be unable to produce $24.20 if they thought a criminal prosecution imminent.*

The respondent, however, by its failure to give notice promptly, and perhaps by its refusal to divulge the facts in its files has caused petitioners to lose a very plausible chance of recovery. The substance of the decision of the Circuit Court of Appeals is that the respondent as a result of whose conduct no proof at all is available must prevail because of the lack of evidence. Certainly there is no equity in such a result.

On May 10, 1936 when the respondent learned of the forgery a possibility of reimbursement existed which did not exist on January 12, 1937 when the petitioners were notified. That possibility of reimbursement unquestionably was of value just as a contingent interest in property is of value, and we do not think it can reasonably be maintained that petitioners were not prejudiced when that possibility of reimbursement was lost. It is, therefore, apparent that even if prejudice is not to be presumed it has been affirmatively proved in the instant case.

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*A careful reading of the opinion of the Circuit Court of Appeals with this topic in mind suggests that that Court may have failed to draw the inference that "Having located the person guilty of cashing a check on a forged endorsement J. C. Penney Company can often obtain restitution from him." Certainly the failure of the parties to fully spell out this point in the stipulation can be remedied by inference or by the judicial knowledge of the court. No specific evidence at all was presented on this point in *Market Street Title & Trust Company* v. *Chelton* (*supra*).

CONCLUSION

For the foregoing reasons we respectfully submit that the judgment of the Circuit Court of Appeals for the Third Circuit should be reversed and the judgment of the United States District Court for the Western District of Pennsylvania affirmed.

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